

CITY OF SEATTLE
King County, Washington
January 1, 1992 Through December 31, 1992

Schedule Of Findings

1. The City Should Not Charge Federal Programs For Reimbursements Of Costs Which Are Not Adequately Supported Or Allowable

Our audit of the Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG) program at the City of Seattle, with expenditures exceeding \$13,000,000, disclosed certain cost reimbursements charged to the program which were unallowable or not adequately supported at the time of the audit, as follows:

- a. Requests for contractor payments totaling \$18,600, submitted by the Central Area Public Development Authority (CAPDA) which administered a CDBG deferred loan program for the city, were falsified. Contractor payments were made without certain required signatures and inspections. This situation is covered in detail in State Auditor's Report No. 55196.
- b. Requests for contractor payments totaling \$18,353.61 submitted to the city by CAPDA, lacked copies of the contractor's invoices at the time of our audit. Three months after our initial request, the city was able to provide contractor invoices supporting \$13,727.61 of the \$18,353.61, leaving questioned costs of \$4,626.
- c. Payments to a contractor, on behalf of homeowner 91-006 and based on requests submitted by CAPDA, exceeded the contract agreement documented in the city's files by \$3,949.30. Again, three months after our initial request, the city provided us with contract change orders supporting the difference. We will therefore not question these costs.
- d. A February 18, 1992, contractor payment request submitted by CAPDA was for the purpose of satisfying a judgment against the homeowner by the contractor originally hired to rehabilitate the home under the loan program. The judgment included interest of \$3,090.81.
- e. Costs totaling \$259.79, representing interest on delinquent City of Seattle drainage service charges levied on real property purchased years ago by the city with Federal Urban Renewal money, were charged to CDBG.

OMB Circular A-87, *Cost Principles for State and Local Governments*, requires all costs charged to federal programs be adequately documented (i.e., vendor invoices, contract change orders).

The circular also states "costs resulting from violations of, or failure to comply with Federal, State and local laws and regulations are unallowable" and "interest on borrowings (however represented) . . . are unallowable."

Questioned costs related to these items, totaling \$26,576.60, are included on the Schedule

of Questioned Costs.

The lack of the contractor invoices and contract change orders was either due to inadequate review by City of Seattle personnel of the contractor payment requests submitted by CAPDA for reimbursement or to poor documentation maintenance. The unallowed costs were apparently due to a lack of understanding that interest or penalty costs are not reimbursable.

We recommend City of Seattle officials institute procedures to prevent payments to contractors without all the required signatures and documents, and to ensure supporting documents are maintained. City officials should also require inspections by city inspectors before the release of final payments for the deferred loan program. We further recommend City of Seattle not seek reimbursement of interest or penalty costs from federal programs.

2. The City Should Improve Administrative Controls Over The Emergency Housing Repair Program

Our audit of the CDBG program also disclosed that administrative controls over the Emergency Housing Repair Program continue to be inadequate and/or not functioning properly.

Our tests of a representative sample of 5 out of a total 106 new Emergency Housing Repair Program loans issued in 1992 disclosed errors relating to 3 of the 5 loans. The same types of errors were noted last year.

We noted one loan in which the final inspection of the repair work performed was not documented and retained in the loan file.

We noted two loans in which an amendment to the borrower's Promissory Note was not appropriately adjusted in the notes receivable subsidiary records. This resulted in a misstatement of notes receivable.

Our review of the notes receivable subsidiary records disclosed that out of the five loans tested, mandatory late charges were not assessed for two loans.

Our documentation, evaluation, and tests of the control structure disclosed the following administrative control weaknesses:

- a. The notes receivable subsidiary report, generated by the department internal accounting system, did not identify whether an account balance was current, deferred, or delinquent.
- b. The past due reports generated by this system did not identify all delinquent accounts. This was primarily because the subsidiary record field search was based on the last payment date rather than the due date.

City personnel stated that most of the problems related to the reports generated by the departmental accounting system resulted from inherent limitations within the system itself. The department has requested funding for a new system.

We recommend City of Seattle officials develop policies and procedures to ensure:

- a. All required documentation is retained in each loan file.
- b. Accounting records adequately identify each loan account balance as current, deferred, or delinquent.
- c. Late payments are identified in a timely manner and delinquent charges are assessed, as appropriate.

3. The City Should Remit Interest Earnings On Cash Draws Of Federal Funds In A Timely Manner

The City of Seattle accumulated and retained \$832.46 of interest income earned on advances of CDBG cash draws. This amount represents total interest earnings on cash draws during 1992 and was remitted to HUD in February 1993.

Code of Federal Regulations Title 24, Part 85, Section 21 requires at least quarterly remittance of interest earned on advances to the federal agency. The grantee or subgrantee may keep interest amounts up to \$100 per year for administrative expenses.

The city installed a new accounting and financial reporting system in January 1991. For this system to clearly identify and separate cash activity between program income and cash draws, some additional accounting codes are needed. These codes have not been added. Consequently, as occurred last year, the city was unable to effectively calculate amounts due to HUD in a timely manner.

We again recommend City of Seattle officials develop policies and procedures to ensure that interest earnings on drawdowns are remitted to HUD in compliance with federal requirements.

4. The City Should Strengthen Monitoring Of Subrecipient Audits

City departments award federal funds to various subrecipient organizations. The individual departments monitor subrecipient audit requirements, requiring an audit if the department has awarded a subrecipient more than \$25,000. The Single Audit Act and OMB Circular A-128 require the city to monitor subrecipient compliance with audit requirements if the city has awarded the subrecipient more than \$25,000. The city has no system to determine subrecipient awards at the city level.

Adjusting the city's accounting system to monitor subrecipient awards at the city level would be complicated and time consuming. Because the city's Department of Housing and Human Services (DHHS) has most of the subrecipients, city personnel believe there is little risk.

We previously noted weaknesses in the DHHS system for monitoring subrecipient audit reports. These weaknesses remain.

- a. DHHS did not obtain all subrecipient audit reports timely and did not follow-up on all subrecipient audit findings.
- b. DHHS does not provide the subrecipients appropriate CFDA numbers in its "agency service agreements." Without the correct CFDA numbers, a single audit cannot be properly performed.
- c. OMB Circular A-133 establishes audit requirements for nonprofit institutions and is similar to Circular A-128 which applies to state and local governments.

The majority of A-133 subrecipients audit reports submitted to DHHS during 1993 did not meet the requirements of the circular. We noted the following deficiencies:

- (1) Subrecipient audit reports due by the end of January 1993 (13 months after fiscal year end) had not been submitted.
- (2) No report on compliance at the financial statement level as required by *Government Auditing Standards* issued by the Comptroller General of the United States.
- (3) Reports on internal control structure used in administering federal financial assistance and compliance with general requirements made no reference to requirements known to be applicable to the federal programs.
- (4) Opinions on compliance with specific requirements applicable to major federal programs made no reference to requirements known to be applicable to the major programs.
- (5) Federal programs misidentified on the Schedule of Federal Financial Assistance as nonfederal, as nonmajor when major, or with the wrong CFDA number. Often the schedule did not identify the major programs. In one isolated instance, the report did not identify any of the "general or specific" requirements tested and the Schedule of Federal Financial Assistance was not included.

The deficiencies in the subrecipient audit reports appear to be due to lack of familiarity with OMB Circular A-133 and the unique requirements of a single audit on the part of DHHS personnel and the subrecipients' auditors. Without proper A-133 audit reports,

DHHS cannot determine whether subrecipients had complied with applicable federal requirements.

We again recommend City of Seattle officials establish a system to determine subrecipient funding at the city level; obtain subrecipient audit reports and follow up on audit findings in a timely manner; and learn to identify substandard reports and reject them. We further recommend the city provide CFDA numbers to all subrecipients.

5. The City Should Physically Inventory General Fixed Assets And Reconcile To Records

Our prior audit reported that the city had not taken a comprehensive physical count of general fixed assets and reconciled the results to the detailed subsidiary ledger for years. In 1992, the finance department started monitoring city departments' progress in performing these physical inventories. As of the last day of our field work, the following city departments had not performed a physical inventory of their fixed assets:

Legislative Department
Engineering Department
Fire Department
Department of Housing and Human Services**
Planning Department
Municipal Court
Office Management and Budget
Library

(** A majority of the city's federal financial assistance programs are administered by this department.)

In addition, although the city's fixed asset inventory system is able to identify equipment purchased with federal funds, city departments do not always enter this information. Equipment purchased by the city using federal funds is subject to the "Common Rule" for *Uniform Administration Requirements For Grants and Cooperative Agreements to the State and Local Governments*, Section .32, which states in part:

(d) Management Requirements. Procedures for managing equipment (including replacement equipment), whether acquired in whole or in part with grant funds, until disposition takes place will, as a minimum, meet the following requirements:

(1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date and cost of the property, percentage of Federal participation in the cost of the property, the location, use and condition of the property and any ultimate disposition data including the date of disposal and sale price of the property.

(2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.

(3) A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property

Strong controls over general fixed assets have not been achieved due to the decentralized nature of the city and assignment of insufficient resources to fixed asset accounting.

Although the city has shown great improvement in its fixed assets accounting, lack of physical inventory of fixed assets increases the likelihood that errors or irregularities could occur and not be detected in a timely manner.

We again recommend City of Seattle officials:

- a. Conduct a physical inventory of fixed assets at least once every two years and resolve any differences between physical inventory, fixed asset subsidiary ledgers, and the general ledger accounts.
- b. Require all city departments to enter into the accounting system the additional information required by federal regulations.

6. The City's Self-Insurance Activities For False Arrest Should Be In Compliance With State Law, Included In The City's Accounting Records, And Properly Reported

The State Auditor's report on the City of Seattle for 1986 contained a finding regarding the Police Department's false arrest insurance. The finding was referred to the State Attorney General's Office but was never resolved. Since that time, state insurance laws and regulations have changed greatly, resulting in the following finding relating to this insurance.

When the world-wide market for this type of insurance was severely constricted in 1985, the city obtained its false arrest insurance policy, as required by union contract, from Meridian Insurance Company Limited in Hamilton, Bermuda. This "offshore rent-a-captive" insurance company is beneficially owned by Willis Carroon Corporation in Nashville, Tennessee. The premium for this policy is expensed in the city's accounting records when the funds are disbursed. The city then transmits the premium directly to the insurance company without using an intermediary, such as an insurance agent, insurance broker, or surplus line broker. The \$25,000 annual "fronting fee" for the privilege of using the services of this company is deducted from the premium after these funds have been received by the insurance company.

This false arrest policy is retrospectively-rated, wherein the insurance company assumes no underwriting risk and merely maintains funds on hand necessary to pay future claims losses. Therefore, risk has not been transferred to the insurance company. As of June 30, 1993, \$1,323,000 was reportedly on deposit with Meridian Insurance Company. In essence, this insurance policy is a self-insurance mechanism of the City of Seattle.

Meridian Insurance Company Limited lacks sufficient capital and surplus to qualify as an alien nonadmitted insurer and has not been authorized by the Washington State Insurance Commissioner's Office to transact the business of insurance in this state. Therefore, this false arrest insurance policy was issued in violation of state law.

As a result, there is no current regulation or oversight by the Insurance Commissioner's Office for the rates, forms, claims, and funds of Meridian Insurance Company Limited. In the event of nonperformance by the insurance company, the city has little or no protection.

The major effects of this self-insurance mechanism for the city's false arrest coverage are as follows:

- a. Funds on deposit with the insurance company are maintained "off-book" and are not controlled by the city. In addition, we cannot determine the security of these funds because they are physically located in Hamilton, Bermuda.
- b. These funds are not invested in accordance with state law. According to the investment policies of Meridian Insurance Company Limited, funds on-hand are invested in the following instruments:
 - (1) Short-term investments include fixed deposits and certificates of deposit with international banks and Euro-commercial paper.
 - (2) Long-term investments include debt obligations of sovereign governments, government agencies, state or provincial governments, and supranational organizations and corporations.
- c. False arrest claims activity is not recorded in the city's accounting records or

reported in its annual financial statements.

- d. The risk management note to the city's annual financial statements does not adequately disclose all insurance activities and operations associated with this insurance policy.
- e. Meridian Insurance Company Limited is not regulated by the Insurance Commissioner's Office or audited by the State Auditor's Office.

RCW 48.05.030 states in part:

(1) No person shall act as an insurer and no insurer shall transact insurance in this state other than as authorized by a certificate of authority issued to it by the commissioner and then in force; except, as to such transactions as are expressly otherwise provided for in this code. . . .

RCW 48.05.215 states in part:

(1) Any foreign or alien insurer not thereunto authorized by the commissioner, whether it be a surplus lines insurer operating under Chapter 48.15 RCW or not, who, by mail or otherwise, solicits insurance business in this state or transacts insurance business in this state as defined by RCW 48.01.060, thereby submits itself to the jurisdiction of the courts of this state in any action, suit or proceeding instituted by or on behalf of an insured, beneficiary or the commissioner arising out of such unauthorized solicitation of insurance business, including, but not limited to, an action for injunctive relief by the commissioner. . . .

RCW 48.15.020 states in part:

(1) An insurer not thereunto authorized by the commissioner shall not solicit insurance business in this state, nor transact insurance business in this state except as provided in this chapter. . . .

RCW 48.15.030 states:

A contract of insurance effectuated by an unauthorized insurer in violation of the provisions of this code shall be voidable except at the instance of the insurer.

Governmental Accounting Standards Board's Statement No. 10, paragraph 7 addresses insurance risk transfer. When the city pays a premium or contribution to an insurer based on the city's actual claims/loss experience, risk has been retained by the city and the annual premium is more in the nature of a deposit. The insurer functions more as a claims servicer.

Chapter 39.59 RCW and Volume 1, Part 3, Chapter 6 of the *Budgeting, Accounting and Reporting System* (BARS) manual specify the various types of investments which are authorized for local governmental entities in the state of Washington. The types of investments listed in the investment policies of Meridian Insurance Company Limited do not meet these criteria.

RCW 39.58.080 states in part:

. . . no public funds shall be deposited in demand or investment deposits except in a qualified public depository located in this state or as otherwise expressly permitted by statute

We recommend City of Seattle officials:

- a. Terminate the false arrest insurance policy with Meridian Insurance Company Limited at the earliest practical time.
- b. Properly include its false arrest self-insurance activities in the accounting records, and adequately disclose related operations in the annual financial statements.
- c. Invest all funds in accordance with state law.

7. The City Should Not Levy Property Taxes In Excess Of Statutory And Ordinance Limitations

In 1985, the voters approved a \$50.2 million bond issue for parks and recreation maintenance. The city issued the bonds in April 1985. By the end of 1990, the city had levied sufficient taxes to pay off the debt, and in January 1991, the city paid the last installment of principal and interest on those bonds.

As disclosed in the Notes to Financial Statements, No. 18, the city inadvertently continued to levy taxes in 1991 for payment of debt service on the 1985 Parks and Recreation bond issue. As of December 31, 1992, the city had overlevied property taxes in the amount of \$10.5 million.

The city intends to refund this overlevy to the taxpayers by reducing its 1994 excess levy by the \$10.5 million.

We recommend City of Seattle officials properly calculate and certify amounts to be raised by taxation in the future.

8. Seattle Municipal Court Should Reconcile Financial Records In A Timely Manner

While some internal accounting control weaknesses noted in our previous audit of the financial records of Seattle Municipal Court have been corrected, those related to reconciliations remained:

- a. The bail trust checking account had not been reconciled to bail pending records. As of December 31, 1992, the difference between the checking account and the Bail Trust Summary Report was \$241,838.75.
- b. The restitutions checking account had not been reconciled to the Municipal Court Information System accounts payable records.

These conditions remain because the reports needed for various reconciliations and verifications of accuracy and completeness of bail pending and restitutions are not produced by the Municipal Court Information System.

A well designed internal accounting control structure includes periodic comparison and reconciliation of actual assets to recorded balances. Without reconciliations and with the lack of accounting reports, the court cannot adequately safeguard and report its financial activities. Additionally, the deficiencies noted above increase the possibility of errors or irregularities occurring and not detected in a timely manner.

We recommend court officials implement an effective internal control structure which includes the following monthly reconciliations:

- a. The bail trust checking account should be reconciled to the bail pending records.
- b. The Restitutions Payable checking account should be reconciled to the Municipal Court Information System's accounts payable records.

We further recommend financial reports be developed and made available to staff to perform the aforementioned reconciliations.

9. The City Should Account For Every Citation Issued

During our audit, we noted that some citations issued by the police department could not be traced to the Municipal Court Information System. Police department and court officials indicated neither department keeps a complete record of all citations.

RCW 46.64.010 states in part:

The chief administrative officer of every traffic enforcement agency shall require the return to him of a copy of every traffic citation issued by an officer under his supervision to an alleged violator of any traffic law or ordinance and of all copies of every traffic citation which has been spoiled or upon which any entry has been made and not issued to an alleged violator. . . .

It also states:

Every record of traffic citations required in this section shall be audited monthly by the appropriate fiscal officer of the government agency to which the traffic enforcement agency is responsible.

We recommend City of Seattle officials assign responsibility and develop a method for tracking citations in compliance with the statute.